DOW THEORY LETTERS INC.

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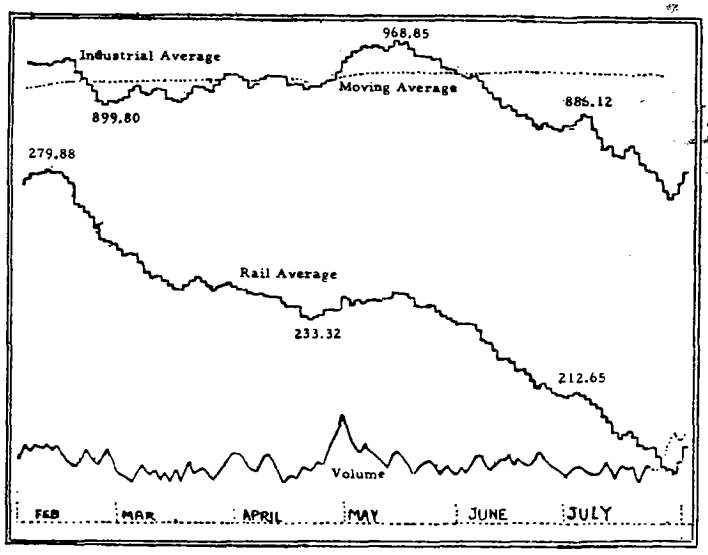
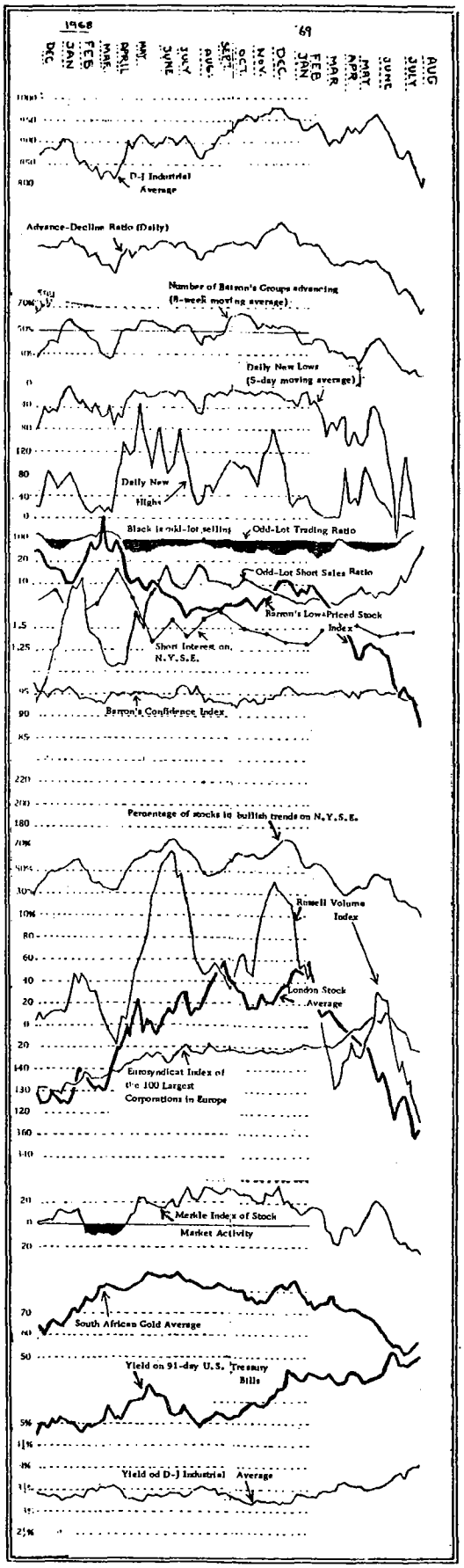
THE MARKET: Between the intermediate peak of May 14 and the recent low of July 29, the breadth of the market and most prices dropped severely. In fact, more issues declined than advanced on 41 of the 51 trading days during the May 14-July 29 period. Within the two months of June and July, 1969 alone, the advance-decline ratio lost a total of 8.55 points, a period of concentrated collapsing breadth which was only equalled during a two-month period in 1962 and before that in 1937.

In going over my monthly A-D ratio chart going back to the 1920's, I can make two observations, observations which, of course, are based entirely on past performance: (1) Such severe breadth collapses covering two months or more obviously produce very "oversold" markets. Consequently, they have been followed by often impressive rallies. (2) In the past, severe breadth collapses of the type seen in June-July, 1969, have not marked the final bottom of the overall downward movement.

The Industrial Average has now declined in an almost straightline plunge from the May 14 peak (968.85) to the July 29 low (801.96). During this period (July 25) the Industrial Average penetrated its 1968 low of 825.13. The 1968 low was one of the critically important points referred to in the last Letter. The 825.13 bottom represented the only intermediate or secondary low since 1966. In breaking that low, Industrials confirmed the previous penetration of the Rails through their own 1968 lows. The conclusion is that the major trend is now obviously bearish, and that the next points of significance are the primary 1966 bear market lows. These lows are 744.32 for Industrials, 184.34 for Rails. A penetration of those lows by both Averages will officially reconfirm the primary bear trend and take the bear market into new low territory.

I believe (as I stated in the last Letter) that the recent action of the Utility Averages has been most significant. On July 25 the Utility Average dropped under its 1966 or bear market bottom, thereby sinking to its lowest level since 1962. Thus the quality Utilities were the first of the three Dow Averages to




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Merkle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield od D-J Industrial Average

set new bear market lows. As a rule during primary movements, a penetration of one Average is confirmed by comparable penetrations in the other Averages. If this observation holds, we should expect Industrials and Rails to confirm the Utilities by plunging through their own respective 1966 lows.

PRIMARY BEAR MARKETS: People seem incapable of grasping the basic concept that bear markets follow bull markets as the night follows the day. And bull markets follow bear markets just as surely. Somehow this concept, which is as old as man, is never really accepted. Instead, people believe what they want to believe: that man is the supreme master of his destiny, and that "this time men and the governments which men have elected have got it all figured out."

Someday, men may control the tides of the ocean, someday men may stop the night, someday men may control the winds, and someday men may end greed, the wish for power, and the urge to speculate. But as this is written the ocean tides still prevail, the night still falls, the winds still blow and men still greedily speculate on the thesis that they can buy an inflated stock and sell it to someone else at a higher price.

Stock holders still tell each other that "this time it is different." They told themselves that in 1907, just before a titanic depositors' panic shook the banking structure of the nation to its knees. The banking system was radically changed, but in 1914 the First World War upset the calculations of market speculators. The War was over in 1918, but a shocking commodity collapse tore the market apart during 1920-21. In 1929 all seemed well, but speculation itself proved to be one of the villains of the 1929-32 debacle. In 1937 an untenable inventory situation set off the bear market crash. The year 1946 amazed Wall Street, since nobody yet can give the reasons why the market collapsed in August, except that the Street suddenly developed a strange "post-war depression" phobia.

Here in 1969 we hear that the "science" of economicshas progressed to such an advanced stage that if any disaster threatened, the Government would simply order increased spending, flood the market with money, press a dozen other buttons and lo, the market would respond like a trained robot. Maybe so, but all that remains to be proved.

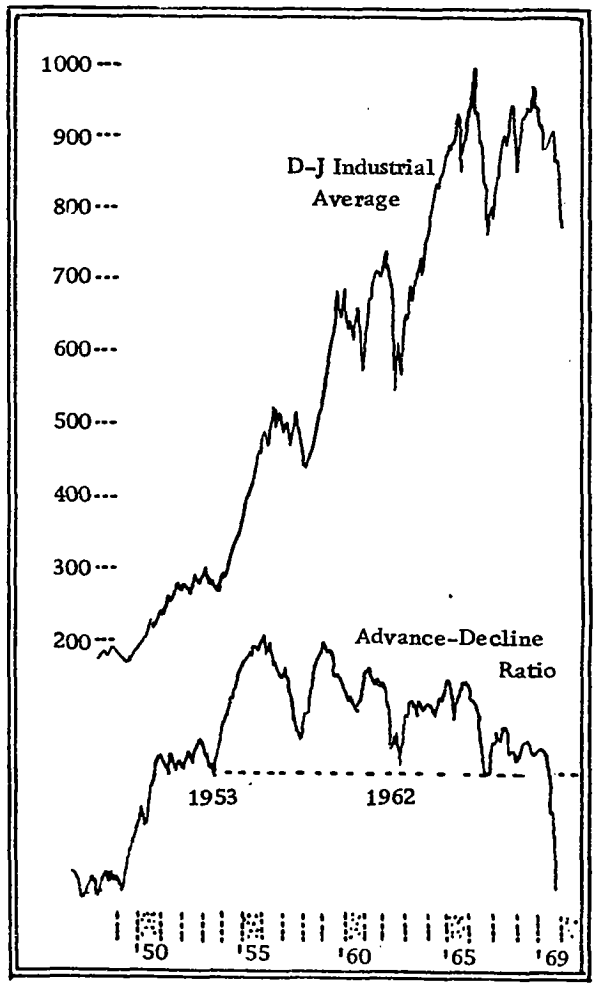
What the optimists of 1969 forget is that primary bear markets don't work like mechanical toys. The reasons behind stock collapses are seldom if ever fully understood in advance, and many stock crashes have defied the most exacting post-mortums.

THE BREADTH COLLAPSE: The Most extraordinary part of this whole bear market, as far as I am concerned, is the action of the advance-decline ratio. As of this writing, the A-D ratio has plunged well below its 1951 low (see chart) and is now in the area of its 1946 and 1948 range. If the weakness continues, it is possible that the A-D ratio will plunge throught the 1947-1948-1949 triple bottom, the great breadth bottom from which the entire 1949-1966 bull market began.

To go back to the only previous example of this type of breadth collapse, we have to examine the 1929-32 example. During the 1921-1929 bull market the A-D ratio struck its ultimate peak in 1925. A slight decline occurred during 1926, and the A-D ratio then pushed half-heartedly up during 1926, 1927 and early 1928. During most of 1928 and 1929 the A-D ratio sagged. During the 1929 crash the A-D ratio plunged, actually penetrating the 1921 bottom from which the whole bull market began.

For comparison purposes, the A-D ratio reached its peak in this cycle in 1956. Despite intermittent rallies, the A-D ratio has sagged ever since (see chart). This year, in the face of one of the worst A-D collapses in history, the breadth line smashed into the 1946-1949 base area.

I do not know whether history is fated to repeat, but it is worth noting that the Dow was in the 160-210 range during 1946-49. It sounds totally absurd to say that the Dow Industrials could confirm the breadth now as they did during 1929-32, but it is sufficient to state that there is currently a vacuum of some 600



points under the Dow Industrials, based on the disparity between the price of the Dow and the position of the A-D line.

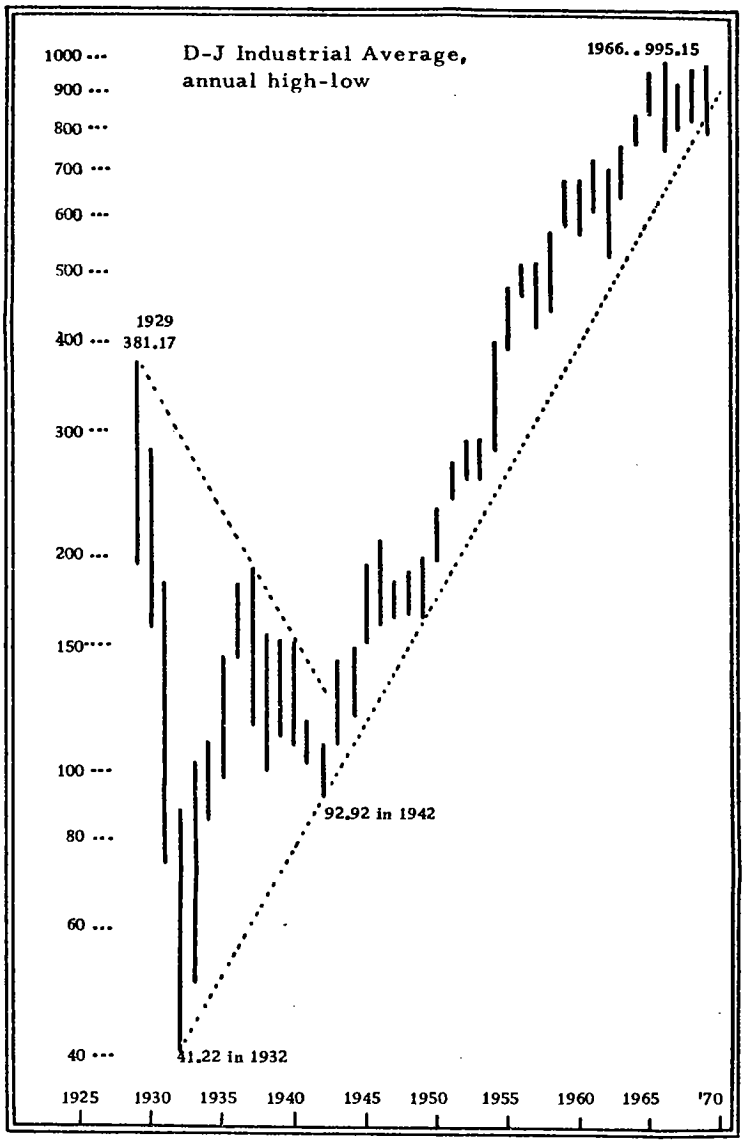
I just received the latest figure on the Dow short interest ratio from my friend Bill Gordon in New York (he is the inventor of this important index). The figure for July is a low .77. This means that the Dow short interest ratio has been under the critical 1.0 level and in bearish territory for eighteen out of the last nineteen months, which is by far the longest period in which the Dow S.I.R. has been under 1.0 in market history. Therefore, this study suggests great technical weakness in the Dow Industrial Average, a condition which I have been calling attention to for almost two years.

The discouraging fact is that the Dow S.I.R. confirms the total market picture of technical weakness. It suggests that the Dow could indeed go a long way towards confirming the collapse of the A-D ratio.

I would not dare to announce that (as in 1929-32) the Dow is on its way to confirming the A-D ratio by wiping out all its gains back to the 1946-1949 period. But these two studies, the A-D ratio and the Dow short interest ratio, are certainly shouting danger. Together, in fact, they have been signaling danger for the past nineteen months. I have kept these two studies up-to-date in Letter after Letter. All my subscribers have therefore been amply forewarned.

LONG-TERM TRENDS: In the last Letter I started by saying that I write about what fascinates me in the stock market. Often what fascinates me is something that no one else seems to be looking at. And all too often, what nobody is looking at turns out to be the most important phenomena around.

Right now I am including what I believe to be two of the most important charts in my collection of hundreds of charts. If the story they are telling is the correct one, history is being made.

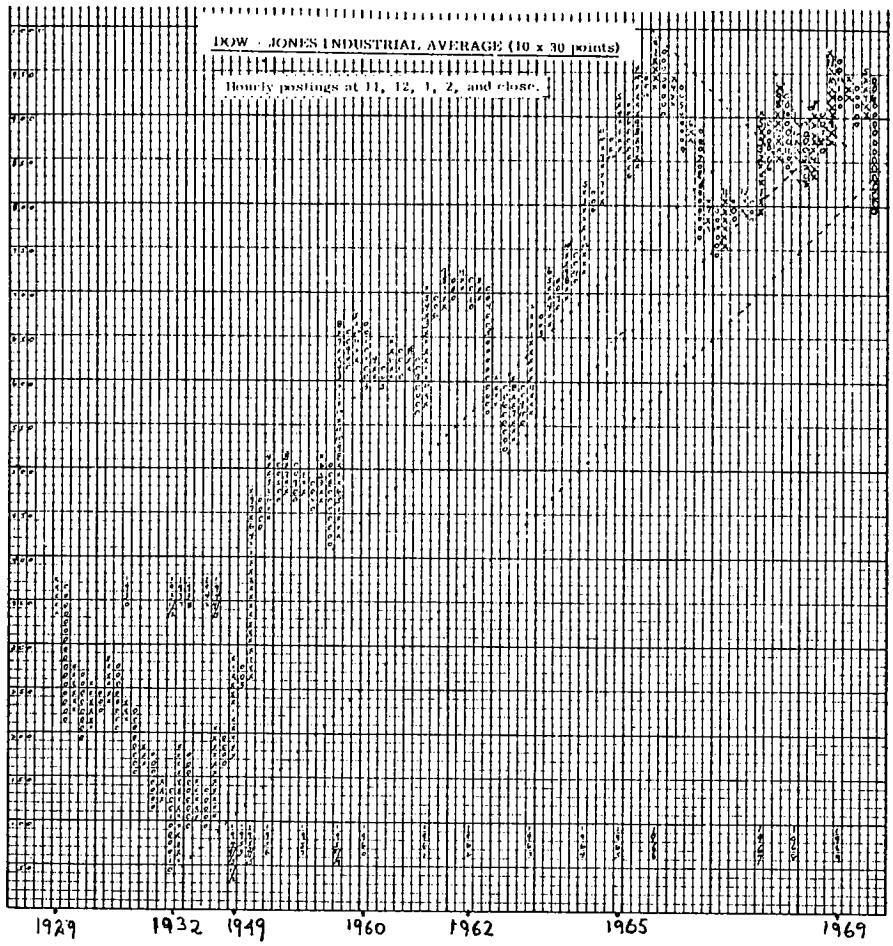


The first chart traces the yearly high-low of the Dow Industrials from the 1929 peak to the current year 1969. The chart is drawn to semi-logarithmic proportions, thereby showing percentages of change. For instance, a move from 100 to 200 on a semi-log chart covers the exact same distance as a move from 300 to 600. This is extremely important because it shows the rate of growth and when that rate changes. For instance, if the Dow climbs at a steady rate of 15% per year for 10 years, that rate will appear as a perfect trendline on a semi-log chart. If the rate lags below 15% the trendline will be immediately penetrated on the downside. Thus, the importance of semi-log charting is that it measures rate of advance or decline, and it shows the point at which that rate changes.

On this chart I have drawn the longest trendline in market history, the trendline connecting the bottoms of 1932, 1942 and 1949. As seen on the chart, this trendline has been respected by Industrials for the past 37 years. But it should be remembered that all trendlines are made to be broken. As a rule, the longer the trendline the more important that trendline. The point where a long trendline is violated represents the point of greatest significance.

As seen on the chart, the Industrial Average has now penetrated the trendline on the downside. I estimate that the trendline now stands in the 850 area. Currently, the Dow has dropped below or reversed the trendline which for 37 years has measured its upward rate of ascent.

What is the meaning of the 1969 reversal? I will hazard my own guess, and it is not a particularly pleasant one. I feel that the reversal shown on the chart is the beginning of a correction which will probably inaugurate a new major downward trendline. Whether the downward trendline which I expect will look like the one which began in 1929 (see chart) I do not know. The rising trendline which began in the early 1920's, as seen on the chart, was steeper than the 1932-1969 trendline, but it was of much shorter duration. Markets tend to equalize over a considerable period of time. Therefore, I foresee the possibility of a very steep downward movement which would serve to correct the entire advance since the 1949 low of 161.60 on the Dow. Or barring a steep and crushing collapse, I would expect a long, drawn-out downward trendline to be formed, one which might hold for many years.



A shorter, steeper collapse could terminate in a few years as per 1929-1932 or 1932-1937. A longer, shallower decline might entail a series of smaller bull and bear markets, such as those seen during the early 1900's.

If I had to guess I would guess that the potential decline would be of the steeper and shorter variety. I base this on the current very vulnerable debt structure of this nation, the monetary chaos and the great amount of "water" and frenzied speculation which is now a part of the equity picture.

The second chart, which is a point-and-figure (P & F) chart would seem to confirm the first chart (P & F chart courtesy of Chartcraft, Larchmont, N.Y.). This is a 10 point, 30 point reversal chart, which means that each box on the chart represents 10 points on the Dow, and that only reversals (rallies or declines) of a full 30 points or more are depicted on this P & F chart. A P & F chart deals with price change, not time, and such charts have the great advantage of showing all important moves in concentrated form.

The Chartcraft method draws trendlines at a 45 degree angle from all tops and bottoms, and I have found that this method works quite satisfactorily. Note on the chart that there is a long, rising trendline from the 1932 bottom. This trendline on P & F has never been closely approached, even by the 1957, 1962 and 1966 declines. This year, (when the Dow plunged to the 800 level) marked the first penetration of the great trendline which extends from the 1932 bottom.

There is no point in going over the significance of this P & F penetration, since I covered that in the discussion of the semi-log chart. But I feel it is significant that these two charts are now confirming each other. I also feel that it is of importance that the trendline penetrations occurred just as Industrials violated their 1968 low of 825.13 (July 25) and as Utilities penetrated their 1966 low of 118.96.

DEBT MOUNTAIN: I have received many letters asking about the fundamentals behind this bear market. In my opinion, if there is one fundamentally bearish force underlying this era it is debt, mountains of debt, towers of debt, the greatest sheer mass of debt in the history of the world.

Let's look at a few statistics. Since 1954, the total debt of this nation increased from $605 billion to $1.6 trillion. This means that the total public and private debt of the U.S. almost tripled during the past 15 years—or in less than a generation! Obviously, this type of thing can't go on, and with interest rates at historic highs the full absurdity of servicing this type of debt explosion becomes patently clear.

Private debt showed the biggest rise. For instance, from the end of 1964 to mid-1969 private debt of all kinds rose 49%! Against this, Federal debt since the end of 1964 has risen 13%, and state and local debt rose 44%. Looking at the whole

spectrum of private debt, the biggest increase came in bank loans and other personal debt, which has risen a whopping 70% since the end of 1964. Consumer debt since the end of 1964 has climbed 44%, farm debt has risen 50%, while private (non-farm) mortgage debt has risen 35%.

In other words, a good portion of the expansion in this nation during the 1950's and 1960's has taken place against a background of compounding and expanding debt. The greater the debt, the higher the interest rate, the greater the rate of inflation needed to keep up with the debt-monster, which by now is gobbling up all the currencies in sight.

There is one major problem in the debt-money supply expansion explosion. As the value of our money decreases, foreign creditors get panicky and domestic savers are wiped out. Pensions of all kinds become worthless, savings are destroyed, bonds collapse and a whole huge segment of the population is thrown "on the rocks." Finally, the monkey wrench of intolerable interest rates hit the inflation machine.

If anyone could calculate the sheer amount of money now required to service the $1.6 trillion in U.S. debt, he would also discover why this nation is being squeezed to death. Even so, the economic machine can keep racing until the first business recession. Just as a car which is accelerating around a curve cannot slam on its brakes, so an economy which is racing with inflation and spending cannot afford a business recession.

During a recession tax receipts to the Government start sliding (during 1929 to 1932 they dropped 50%). What will happen if this country goes into a business recession with its current load of debt? Frankly, I don't know, but I would guess that when the Government finds that it has to service its huge debt in the face of falling tax receipts, all hell is going to break lose. Unbelievable Federal deficits are going to loom, and in order to cover those deficits Uncle Sam is going to come into the bond market with giant, new bond issues. That should mark the final climax of the bear market in bonds which began in 1946 and which is continuing to this day.

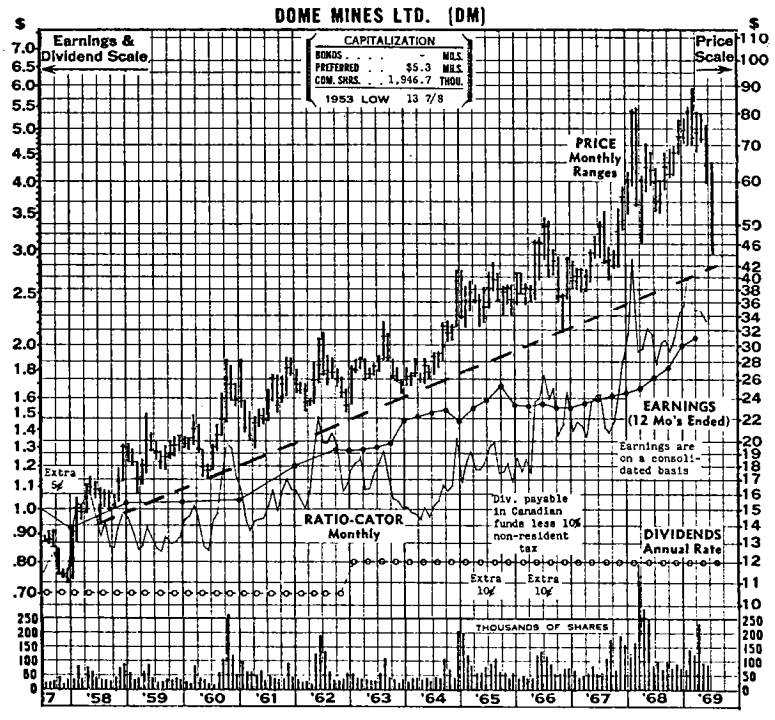
And that is exactly why I believe that the whole bond structure is headed for one final, frightening collapse, a collapse which will produce interest rates never before seen in the U.S. At that time our Government will have to face the fact that it cannot do what it wants, it can only do what it can afford. It is going to set off a revolution in thinking in this country, and at that time I believe the price of gold will be doubled or tripled as the whole fiscal structure of the U.S. is changed in an effort to bring us out of the mess.

The picture, as painted above, is one of the things which I think this bear market is all about. The conclusion will not be over in a hurry, it will take time, agony, thinking and re-thinking. It will be part of the great upheaval of our time, an upheaval which has been presaged by the social revolution which has been obvious since World War II.

GOLD: On July 25 the Group of ten approved $9.5 billion in S.D.R.'s or "paper gold" to be pumped into world reserves over the next three years. This is supposed to solve the world liquidity problem. Conceivably, it could help if everything were to go along in a "normal" way. But I rather think that the normal way is not fated to be.

My guess is that the primary bear forces are now beginning to envelope the markets of the world. If and when the Dow Industrials smash the 1966 low of 744.32, the second (psychological) phase of the primary bear market will be on in full. Within six months from such an event, I would expect the world to be struggling with the forces of depression. The true fear will then come when the Government reverses all its anti-inflation measures—and the reversals fail to stem the tide of liquidation.

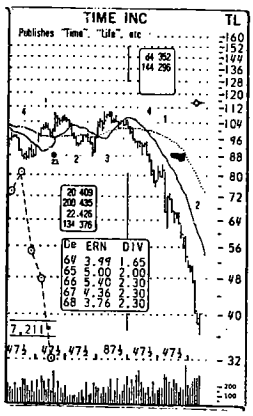
Then the need for a fundamental rise in world liquidity will come to the fore. And one of the things which will be done is to double or triple the price of gold—in an effort to get the world back on the "growth" trail again.


DOME MINES LTD. (DM)
Earnings & Dividend Scale
Price Scale
CAPITALIZATION
BONDS . . . - MILS.
PREFERRED . . . $5.3 MILS.
COM. SHRS. . . 1,946.7 THOU.
1953 LOW 13 7/8
PRICE Monthly Ranges
EARNINGS (12 Mo's Ended)
Earnings are on a consolidated basis
Extra 5¢
RATIO-CATOR Monthly
Div. payable in Canadian funds less 10% non-resident tax
DIVIDENDS Annual Rate
Extra 10¢
Extra 10¢
THOUSANDS OF SHARES
'57 '58 '59 '60 '61 '62 '63 '64 '65 '66 '67 '68 '69

I include a chart of a volatile leading North American gold issue—Dome Mines (see page 5). Drawing in the last important trendline we can see what has occurred in this stock. I believe that this is a major shake-out. It has been brought on by a lack of buyers in the face of sellers and a thin market. Those who are hedged in gold now have all the shares they need. They are not thinking in terms of buying more. Thus, with the thin market and disillusioned sellers, gold shares are taking it on the chin. My advice.....keep holding your shares.

I should note that all along I have stressed that we hold a 10% to 15% hedge position in gold shares. I will again explain why. Take a theoretical account with $100,000. We have say $15,000 in gold shares and $85,000 in Treasury bills. Gold shares decline 33%. This means a 5% paper loss in the overall account, not bad in view of what has happened to most accounts in today's market.

Now say that the price of gold is doubled and the $15,000 in gold shares triples in value to $45,000. Figuring $85,000 in bills and $45,000 in gold shares, the original account has now appreciated 30%, and this during a primary bear market. Thus, the 15% gold hedge shows an approximate loss risk of perhaps 5% on the downside and perhaps a gain of 30% on the upside. That's the meaning behind the gold hedge which I have been advocating, and thosewho have followed my thinking are still in excellent shape. In far better shape than the many thousands of people who are now sustaining losses in stocks of 50% and more. (Dome chart courtesy of Security Research, 208 Newbury St., Boston, Mass.).



STOCKS: The viciousness of this bear market can be illustrated by the action of mighty Time, Inc., largest publisher in the world. With earnings at Life off and with a squeeze on profits in other divisions, Time hit a double top in the 112 area during 1968. The stock broke the critical 84 area in March, 1969. From there a sweeping plunge took Time to a low of 36 3/8 in late-July. The collapse succeeded in wiping out two-thirds of the market value of one of America's great corporations. (Chart courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas).

ECONOMIC SCRAPBOOK:

July 24.....Orders for durable goods dropped for the second consecutive month, this time by 3%. Consumers' prices rose at a 7.2% rate, thereby doubling the May rate. GM reports a 17% drop in second quarter earnings as all three big motor stocks hit new 1969 lows on the N.Y.S.E.

July 25.....Group of 10 agrees on $9.5 billion of S.D.R.'s or "paper gold" to be pumped into world economy over the next three years. French reserves in week ending July 17 dropped $24 million and are now less than half of reserves prior to 1968 riots.

July 28.....Second quarter machine tool orders set a record for the decade. Mutual fund sales in July dropped 10% behind the June level which were 19% behind the May level. The Municipal Bond Average's yield rocketed to a record high of 5.98%.

July 29.....U.S. announces a budget surplus of $3 billion, first in nine years. Senate Majority Leader Mansfield announced that the 10% surtax will die. June construction contracts sagged 14% from May. The price of wheat plunged to 27-year lows.

July 30.....Municipal bond market turns chaotic as the House prepares a bill to curtail the tax-exempt status of all such issues. U.S. Steel announces a 48% drop in its second quarter profits.

July 31.....Belgium lifts her bank rate from 6% to7%. U.S. Treasury issues 18-month notes with 7.75% rate of interest, highest since 1859.

Aug. 1.....A House Committee cleared a bill calling for $6.5 billion in tax reductions for lower income taxpayers. Higher taxes were scheduled for the wealthy. Chain store sales rebound smartly from the June levels. Steel price increases covering half the industries tonnage were going into effect.

Aug. 4.....Car sales still sliding as GM reports a 14% drop in the last 10 days of July.

ARTICLE OF THE WEEK: I couldn't resist including this incredible story which was translated from Paris Express by Atlas magazine.

But for an unfortunate occurrence Professor Tsien Hsue-chen, who is China's Werner von Braun, might be an American today. He came to the U.S. in 1935 and soon became a respected member of the U.S. scientific community. His mentor, Theodore von Karman of the California Institute of Technology, called him a genius.

In 1946, after the German surrender, Karman and Tsien were sent to Germany to study the secrets of the V-2 rocket. By autumn, the first American rocket was launched in the New Mexico desert and Tsien, who had been promoted to Colonel, had of course been one of its designers. It brought him Government honors. Four years later in 1950 Professor Tsien decided to ask for naturalization.

The Korean War had helped spark a communist witchhunt in the United States. A California police officer found Tsien's name on a list of members of a long-defunct communist cell. Tsien's friend Dan Kimball, then Under Secretary of the Navy, said, "I would rather see him shot than back in China." Nevertheless, he was arrested, then freed, but excluded from all classified research.

Mortified by the accusations and disillusioned with an America he had admired, he slipped over the Chinese border at Hong Kong on the night of October 8, 1955. No one in the West has seen him since.

He was not alone. Of 200 Chinese scientists who took part in developing China's nuclear armament, almost half—and all of the top men—came from the U.S. The miasma of suspicion had driven them from its universities.